

# **Tax News**

## **December 2007**

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**Legislative wrap-up 2007**

Here is our annual summary of tax-related legislation enacted this session.

**Assembly bills:**

**AB 14 (Laird, Stats. 2007, Ch. 568):** Establishes the Civil Rights Act of 2007, which amends various California Codes to redefine characteristics that form the basis for prohibited discrimination.

**AB 28 (Huffman, Stats. 2007, Ch. 486):** Extends the California Breast Cancer Research Fund voluntary contribution “check-off” from 2008 to 2013.

**AB 62 (Nava, Stats. 2007, Ch. 224):** Adds the wildfires that occurred in El Dorado, Santa Barbara, and Ventura counties to the current list of specified disasters under the Personal Income Tax and Corporation Tax Laws.

**AB 67 (Dymally, Stats. 2007, Ch. 259):** Adds definitions for “qualified bilingual person, employee, or interpreter” and would expand the instances in which a state agency may be exempted from the requirements of delivering bilingual services.

**AB 198 (Assembly Budget Committee, Stats. 2007, Ch. 381):** Amends current law to do the following:

- Determine an LLC's fee based on the LLC's total income from all sources derived from or attributable to the state. The level of activity would be determined by applying the current law's franchise/income tax sales factor rules to the total income of the LLC (as defined in the bill) in order to calculate the amount of total income from all sources derived from or attributable to the state.
- Provide that if the LLC fee is finally adjudged to be discriminatory or unfairly apportioned, any taxpayers that file claims for refund asserting that the LLC fee is discriminatory or unfairly apportioned would have the amount of their claim for refund calculated in an amount necessary to remedy the discrimination or unfair apportionment required by the statute.

**AB 297 (Maze, Stats. 2007, Ch. 225):** Adds the fruit and nut trees that were severely damaged by the freeze of January, 2007, to the current property tax exemptions allowed for trees subject to other specified freezes.

**AB 299 (Tran, Stats. 2007, Ch. 130):** Makes technical, non-substantive changes to various code sections, including the Revenue & Taxation Code.

**AB 361 (Ma, Stats. 2007, Ch. 105):** Requires an administrator or executor of a deceased person's estate to provide notice of the estate's administration to FTB no later than 90 days after the date letters are first issued to a general personal representative. Any estate opened on or after July 1, 2008 must provide to FTB notice of the estate's administration.

**AB 367 (De Leon, Stats. 2007, Ch. 132):** Makes the following changes to the existing Court Ordered Debt Collection program:

- Reduces the minimum amount of court ordered debts referred for collection to FTB from \$250 to \$100.
- Adds public defender fees to the county collection programs for court ordered debts.
- Authorizes debt referrals based on violations for parking and registration, and offenses by pedestrians and bicyclists.

**AB 650 (Lieu, Stats. 2007, Ch. 606):** Requires employers to notify employees of their potential eligibility for the federal earned income tax credit.

**AB 897 (Houston, Stats. 2007, Ch. 238):** Eliminates the requirements for certain federally tax-exempt entities to apply for California income tax exemption. Specifically, this bill would allow 501(c)(3) organizations that are granted federal tax-exempt status to submit a copy of the IRS tax-exempt notice to FTB to establish California income tax exemption. 501(c)(3) organizations would no longer be required to file an exemption application with FTB or submit a \$25 filing fee.

**AB 1020 (Runner, Stats. 2007, Ch. 277):** Authorizes the recorder of any county to accept for recording, in lieu of paper, digitized images or digital images or both of a recordable instrument, paper, or notice under the following conditions:

- The image conforms to all other applicable statutes that prescribe the criteria for recordability.
- The requester and addressee for delivery of the recorded images are the same and can be readily identified as a local or state government entity or an agency, branch, or instrumentality of the federal government.

**AB 1168 (Jones, Stats. 2007, Ch. 627):** Requires FTB to truncate Social Security Numbers (SSNs) by redacting the first five digits of the SSN. The SSN would be redacted on any record created by FTB that is disclosable under the Public Records Act and expressly includes tax liens.

**AB 1199 (Richardson, Stats. 2007, Ch. 408):** Applies existing provisions of the white collar crime enhancement statutes to include cases where the felonious acts result in the loss of more than \$100,000.

**AB 1360 (Anderson, Stats. 2007, Ch. 281):** Requires that Notice of Proposed Assessments and final deficiency notices issued by FTB be postmarked for all notices issued on or after January 1, 2008.

**AB 1747 (Assembly Revenue & Taxation Committee, Stats. 2007, Ch. 341):** Makes three changes to the Revenue and Taxation Code:

- Revises check-casher reporting requirements to exclude government, payroll, and one-party checks, as defined.
- Defines the term "last known address" for legal notices.
- Changes the date that the annual Taxpayers' Bill of Rights Report is due to the Legislature from October 1 of each year to December 1 of each year.

**AB 1748 (Assembly Revenue & Taxation Committee, Stats. 2007, Ch. 342):** Amends existing law to more closely conform to federal law by applying the general statute of limitations for claims for refund to complete/partial relief and by disallowing any claims for refund for separate allocation relief.

**Senate bills:**

**SB 38 (Battin, Stats. 2007, Ch. 222):** Adds the wildfires that occurred in Riverside County in October, 2006, to the current list of specified disasters under the Personal Income Tax and Corporation Tax Laws.

**SB 41 (Battin, Stats. 2007, Ch. 1):** Adds an uncoded provision to the Revenue and Taxation Code that allows payments made by certain tax-exempt organizations to the family members of any firefighter who died as a result of the October, 2006, Esperanza fire to be treated as payments made in furtherance of the charitable purpose of that organization, to prevent the loss of that organization's California tax-exempt status.

This act specifically states that the provision would apply to any payments made on or after October 26, 2006, and before June 1, 2007.

**SB 87 (Senate Budget Committee, Stats. 2007, Ch. 180):** Repeals the Teacher Retention Tax Credit.

**SB 105 (Migden, Stats. 2007, Ch. 426):** Makes technical changes with respect to how Registered Domestic Partnerships calculate joint federal adjusted gross income (AGI) for the purpose of computing limitations for state purposes, to be consistent with the calculation of joint federal AGI limitations for married persons.

**SB 114 (Florez, Stats. 2007, Ch. 223):** Allows taxpayers special disaster loss treatment for losses sustained resulting from the January 2007 freezing conditions.

**SB 519 (Senate Governmental Organization Committee, Stats. 2007, Ch. 92):** Authorizes a state body to call a special meeting for purposes of providing for an interim executive director of the state body upon the death, incapacity, or vacancy in the office of the executive officer.

**SB 644 (Correa, Stats. 2007, Ch. 189):** Removes the requirement that an abstract of judgment contain the debtor's full Social Security number (SSN), and replaces it with the requirement that only the last four digits of that debtor's SSN be shown. This requirement to show only the last four digits of the SSN would be applicable to other related court documents, such as Amendments to an Abstract of Judgment.

**SB 788 (Cogdill, Stats. 2007, Ch. 306):** Allows FTB to apply discretion for deciding when to examine water's-edge taxpayers for noncompliance issues, including transfer pricing, based on an analysis of **all** factors, including the relative levels of noncompliance and materiality.

**SB 898 (Simitian, Stats. 2007, Ch. 665):** Extends both the State Children's Trust Fund and the Fish and Game Preservation Fund check-off from 2008 to 2013.

**SB 920 (Oropeza, Stats. 2007, Ch. 666):** Authorizes FTB, subject to federal requirements, to annually provide the State Controller's Office with specific information from the business entity returns or other business entity records maintained by FTB. The information authorized for disclosure by this act includes the following:

- Taxpayer name.
- Taxpayer identification number.
- Taxpayer address.
- Taxpayer's principal business activity code.

**SB 1043 (Senate Revenue & Taxation Committee, Stats. 2007, Ch. 309):** Excludes evidence of settlement negotiations with FTB in administrative and civil tax dispute forums in California.

**SB 1044 (Senate Revenue & Taxation Committee, Stats. 2007, Ch. 156):** Removes any ambiguity regarding the authority of FTB to disallow deductions for unreported payments made for personal services, by eliminating obsolete cross references.

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## California tax-exempt process streamlined

Passage of Assembly Bill (AB) 897 affects organizations that have obtained federal exemption under Internal Revenue Code (IRC) Section 501(c)(3). This new law is effective January 1, 2008, and should expedite the process for many organizations seeking California tax-exempt status.

Organizations that possess a federal determination letter under IRC 501(c)(3) can request California affirmation of tax exemption from us (under California Revenue & Taxation Code (R&TC) Section 23701d) by sending us a copy of the federal exemption. AB 897 only applies to organizations that have obtained their federal exemption letter under IRC Section 501(c)(3). It does not release organizations from fulfilling California's exemption law requirements. Organizations that do not fulfill California's requirements, will not receive affirmation of federal tax-exemption.

We created Form 3500A (*Affirmation of Internal Revenue Code 501(c)(3)*) for organizations affected by this bill. Those seeking state tax-exempt status based on their federal tax-exempt status will complete this new form, and attach it as a cover sheet along with all the pages of the federal determination letter.

This new law does not change any of California's filing requirements for FTB Form 199, *California Exempt Organization Annual Information Return*; FTB Form 109, *California Exempt Organization Business Income Tax Return*; or FTB Form 100, *Corporation Tax Return*.

## Frequently Asked Questions

Check out our **FAQs** for answers to questions you may have about this new law:

**My organization has a federal exemption under IRC Section 501(c)(3). What do I need to do to get California state tax exemption?**

If your organization has already received a determination letter from the IRS granting exemption under IRC Section 501(c)(3), you may request California affirmation of federal exemption by filing form FTB 3500A, *Affirmation of Internal Revenue Code Section 501(c)(3)* with the federal determination letter attached. You are not required to submit the application fee of \$25.

- Download FTB 3500A from our [Forms and Publications page](#).
- Submit the *Affirmation* request at least 90 days before the date your organization needs exempt status so we will have adequate time to process your request.

**Does it matter if the effective date of my federal tax-exempt status is different from my organization's incorporation date?**

Yes. For state income tax purposes, the effective date of an organization's tax-exempt status shall be no later than the federal effective date. Organizations whose federal effective date differs from their date of incorporation date, should consider filing form FTB 3500, *Exemption Application*.

**Example:**

- ABC organization incorporated on 12/31/1999.
- Federal effective date 12/31/2002.
- ABC organization filed form 3500A.

The state's effective date for ABC organization is 12/31/2002. In order for ABC organization to avoid the minimum franchise tax or annual tax, ABC organization must file form FTB 3500, *Exemption Application* to request retroactive to 12/31/1999.

**How are limited liability companies (LLCs) affected by AB 897?**

California does not allow tax-exemption for single member LLCs under R&TC Section 23701d. LLCs must elect to be treated as a corporation to be able to be granted exemption under R&TC Section 23701d.

**When will my organization be considered to have exempt status?**

You cannot consider your organization exempt for tax purposes until we have issued the affirmation of federal exemption letter.

All corporations and unincorporated associations, even if organized on a nonprofit basis, are subject to California franchise or income tax. Trusts organized and operated for purposes described in R&TC Section 23701d are treated as nonprofit corporations for exemption purposes.

**My organization does not have federal exemption (or is exempt under a different Internal Revenue Code section). How do I obtain tax-exempt status for California?**

If your organization does not have federal exemption, or is exempt under a different IRC section, you may request California franchise or income tax exemption by filing an *Exemption Application* form FTB 3500.

To obtain exemption from California franchise or income tax for your organization, you must send us an *Exemption Application* form (FTB 3500), a \$25 check for the application fee, and all required documents.

- Download FTB 3500 from our [Forms and Publications page](#).
- Submit the *Exemption Application* request at least 90 days before the date your organization needs exempt status so we will have adequate time to process your request.

We must issue a determination of exemption letter.

**When will my organization be considered to have exempt status?**

You cannot consider your organization exempt for tax purposes until we have issued the determination letter. Trusts must include a copy of the federal determination letter before state exemption will be granted.

**Can an inactive organization obtain tax-exempt status?**

No. An inactive organization is not entitled to exemption. Organizations seeking to obtain and retain exempt status must meet requirements that they are organized and operating for nonprofit purposes within the provisions of their exempt code section.

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**New alimony audit project is underway****Pilot project reveals 40 percent noncompliance rate**

Your clients who receive or pay alimony need to be aware of a new audit project examining alimony payments. The alimony audit project was initiated by a pilot study that indicated a 40 percent noncompliance rate, affecting multiple years in most cases.

Alimony payments are only deductible by the payer spouse under Internal Revenue Code (IRC) Section 215 (California Revenue and Taxation Code (R&TC) Section 17201) if they are taxable to the recipient spouse under the provisions of IRC Section 71 (California R&TC Section 17081). If the divorce or separation agreement designates such payments as not includable in the recipient's income, then the ex-spouse making the payments cannot deduct them. For example, property settlements are not includable as alimony income and are not deductible.

Generally, alimony deductions appear on line 31 of the federal Form 1040. Analysis of the pilot's results revealed a 40 percent adjustment rate (the amount of alimony deduction or alimony income stated on the tax return was either increased or decreased), generating an average of \$5,800 in added tax per return. Analysis also revealed that when there was an adjustment, it involved multiple years. The results were nearly equally divided between those paying alimony, and those receiving alimony.

Our analysis of divorce decrees shows that many taxpayers mistakenly consider all payments made to their ex-spouses as deductible alimony payments. For example, taxpayers frequently include non-deductible child support payments as alimony deductions. On the other hand, many alimony recipients do not consider the payments from their ex-spouses as taxable income, and do not report it. Some recipients make the common mistake of not reporting income designated as "family support" by the divorce decree. This type of support is considered alimony income in most cases.

If the support payments are taxable, the recipient must report them on the tax return for the year received. Alimony income is reported on line 11 of the federal Form 1040, and carries through to the California return. If we propose an audit adjustment, we will mail a "*Tax Liability Discrepancy*" letter to the taxpayer instead of conducting a complete and time-consuming audit. If the taxpayer agrees with our audit determination, the taxpayer can pay the tax and interest, and be finished with the process. If the taxpayer disagrees, we will request substantiation from the taxpayer supporting the taxpayer's position.

The pilot program showed that sending a letter to the taxpayer regarding the understatement is cost-effective and efficient. Taxpayers agreeing with the letter typically paid within one week of receipt.

In Phase Two of the alimony project, we plan to develop a Frequently Asked Questions (FAQ) brochure, which would be included in the letters sent to taxpayers with alimony issues. The FAQs will help taxpayers more clearly understand what is and what is not alimony, as well as address applicable penalties.

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## **FTB scrutinizes car and truck expense compliance**

### **Finds 80 percent noncompliance rate**

A recent audit self-compliance pilot project examining car and truck expenses claimed on Schedule C, *Gross Profit or Loss from Business*, revealed an unwelcome result: taxpayers incorrectly reported their car and truck expenses on more than 80 percent of returns selected.

In a 2006 article (see *Closing the Small Business Tax Gap*, 03/01/06 on [Forbes.com](http://Forbes.com)), the IRS estimated that Americans underpaid their federal taxes by \$345 billion in 2001. Special research audits the IRS conducted on 2001 returns indicated that individual taxpayers reported just 57 percent of their business income.

California Revenue and Taxation Code Section 17201 conforms to IRC Section 162 allowing taxpayers to deduct all ordinary and necessary expenses paid during the taxable year in

carrying on any trade or business. Ordinarily, expenses related to the business use of a car, van, pickup, or panel truck can be deducted as transportation expenses.

Your client can deduct transportation expenses:

- Incurred while driving from his home to a client's place of business while conducting business.
- Between one place of business and another place of business if they are business-related.

Your client can **never deduct** transportation expenses between his home and his business or regular place of work, as those are personal commuting expenses.

The Personal Income Tax program initiated the Car and Truck Expense Self-Compliance pilot project as one of the department's efforts to reduce California's tax gap, which is estimated at \$6.5 billion. Based on earlier studies, there is a high rate of noncompliance related to car and truck expense deductions in tax returns. The pilot program's intent is to encourage self-compliance by first educating taxpayers, and then giving them an opportunity to correct any filing errors, rather than undergo the more "traditional audit." In a traditional audit, an auditor requests specific substantiating documentation, performs the analysis, computes the revised tax, and issues a proposed assessment.

Our audit staff mailed self-compliance letters to taxpayers who claimed the car and truck expense. The self-compliance letters included Frequently Asked Questions (FAQs), the applicable law, and a simplified auto expense worksheet(s) for taxpayers to determine the allowable amount of their car and truck expense deductions. Taxpayers were asked to indicate on the worksheet their business and commuting mileage, and details of actual expenses incurred such as gas, insurance, parking, etc. The self-compliance letter listed the names and phone numbers of the Auditor, Audit Lead, and Audit Supervisor, to address any questions or concerns a taxpayer may have had about the self-compliance letter. Taxpayers that believe they paid additional tax in error in response to this self-compliance letter should follow the normal administrative remedy of filing a claim for refund.

The results of the Car and Truck Expense Self Compliance pilot project revealed that the taxpayer incorrectly reported their car and truck expenses in more than 80 percent of the returns selected. Using the forms provided with the self-compliance letter, taxpayers were able to self-correct these returns and pay the correct amount of tax.

The use of self-compliance letters grew out of the Voluntary Compliance Initiative, which provided taxpayers an opportunity to self-comply to avoid undergoing compliance actions.

Because this approach encourages self-compliance by educating taxpayers, and lowers the cost of tax administration for all taxpayers, self-compliance letters are an audit tool that we will consider for future use. It allows us to continue to educate taxpayers, address the tax gap, and promote self-compliance - all of which are essential to good tax administration.

## Example: Self-compliance letter



STATE OF CALIFORNIA  
FRANCHISE TAX BOARD  
300 Spring Street Suite 5704  
Los Angeles CA 90013

Date:

JOHN DOE  
1111 ABC PLACE  
LOS ANGELES CA 90013

Account No.: 111111111  
Tax Year(s): 2004

Your return(s) have been assigned to this office for examination of the car and truck expense(s) reported on the Schedule C. We enclosed an explanation of the *Applicable Law*, some *Frequently Asked Questions* and an *Auto Expense Worksheet*. It is important that you read our *Frequently Asked Questions*, as they will answer many of your questions. After you have reviewed the *Frequently Asked Questions*, please complete and return the *Auto Expense Worksheet* to this office within 15 days from the date of this letter.

A self-addressed envelope is included for your convenience.

We will review the information you provide and determine the correct tax liability.

Thank you for your cooperation. If you have any questions regarding this matter, please call me at the number listed below.

Tax Auditor  
Telephone: (111) 111-1111  
Facsimile: (222) 222-2222

Enclosures: Frequently Asked Questions  
Applicable Law  
Auto Expense Worksheet  
Return Envelope

If you have any questions regarding the examination process and cannot resolve them with me, you may contact my audit lead or supervisor at the numbers listed below:

Jane Doe, Lead  
John Smith, Audit Supervisor

(333) 333-3333  
(444) 444-4444

## Frequently asked questions

### Why did Franchise Tax Board contact me?

We contacted you because you claimed an auto expense deduction. Earlier studies indicate a high rate of noncompliance in this area. We are requesting that you recheck and verify deductions for auto expenses claimed on Schedule C.

### How do I determine the deductible amount of automobile expense?

You can determine your deductible amount by completing the enclosed *Auto Expense Worksheet*.

### What if I need assistance completing the *Auto Expense Worksheet*?

For assistance, you may call the auditor on the cover letter or you may consult your tax advisor.

### Can I use one *Auto Expense Worksheet* for multiple vehicles?

No. We have included one copy of the *Auto Expense Worksheet* for your convenience. If you listed expenses for more than one vehicle on your Schedule C, please photocopy the *Auto Expense Worksheet* provided, and fill out a separate worksheet for each vehicle.

### What if my return is correct and does not require any changes?

If you believe your auto expenses are correct, you still need to complete the *Auto Expense Worksheet* and return it to us.

### How will the *Auto Expense Worksheet* be used?

We will review your completed *Auto Expense Worksheet*. We may contact you to verify the amounts you entered on the worksheet. If necessary, we may request your tax records supporting the auto expense deduction. We will notify you of any difference.

### What happens if I do not return the *Auto Expense Worksheet*?

We may disallow your auto expenses, and your return remains subject to audit.

### Where do I send my completed *Auto Expense Worksheet*?

Please send your response to the following address:

FRANCHISE TAX BOARD  
ATTN: AUDITOR'S NAME  
STREET ADDRESS  
CITY, CA ZIP CODE

We enclosed a self-addressed envelope for your convenience.

## Applicable law

According to Internal Revenue Code Section 163(h), taxpayers must separate expenses that are both business and personal. You can only deduct the part that is a business expense. Internal Revenue Code Section 162 defines deductible business expenses.

California Revenue and Taxation Code Section 17201 conforms to Internal Revenue Code Section 162.

## Automobile expenses

You can use one of the two following methods to figure your deductible expenses:

- Standard mileage rate.
- Actual automobile expenses.

If you qualify to use both methods, you may want to figure your deduction using both methods to see which gives you a larger deduction.

### Standard Mileage Rate

Compute your allowable business mileage by completing the attached worksheet. The standard mileage rate for business miles is:

2002 - \$0.365  
 2003 - \$0.360  
 2004 - \$0.375

If you want to use the standard mileage rate for a car you lease, you must use it for the entire lease period.

## Actual auto expenses

If you do not use the standard mileage rate, you may be able to deduct your actual car expenses. Actual auto expenses include: depreciation, gas, insurance, lease payments, licenses, parking fees and tolls, registration fees, and repairs and maintenance.

## Worksheet example

Jane reported an Auto Expense Deduction of \$7,000 on her 2003 Schedule C. Jane drove a total of 20,000 miles in 2003. The total commuter mileage between Jane's home and her principal job site was 8,000. The total mileage driven for personal and pleasure purposes was 3,000. Jane leased her vehicle. Jane has a written mileage log substantiating 7,000 business miles for the year.

### Computation of standard mileage rate:

1. Total annual miles driven.	<u>20,000</u>
2. Less: total miles commuted between home and business/workplace.	<u>&lt; 8,000 &gt;</u>

- |  |                        |
|--|------------------------|
| 3. Less: total miles attributed to personal purposes (shopping, vacation, etc.).   | <u>&lt; 3,000 &gt;</u> |
| 4. Total miles driven for business purposes.<br>(Line 1 <minus> Line 2 <minus> Line 3 = Line 4)  | <u>9,000</u>           |
| 5. Enter the amount of mileage that you have written support for.<br>(Line 5 cannot exceed line 4) <b>(Please ensure that you have mileage log, travel calendar and other documents to support this)</b> | <u>7,000</u>           |
| 6. Multiply line 5 by \$.360. This is your total standard mileage deduction.   | <u><b>\$2,520</b></u>  |

**Computation of actual auto expenses: (Please ensure that you have the vendor invoices, receipts and other documents to support these expenses)**

- |  |                    |                        |
|--|--------------------|------------------------|
| 7. Total actual auto expenses:   |                    |                        |
| a. Depreciation  | <u>\$0</u>         |                        |
| b. Lease payments  | <u>\$5,000</u>     |                        |
| c. Registration fees   | <u>\$ 250</u>      |                        |
| d. Licenses fees   | <u>\$ 250</u>      |                        |
| e. Cost of repairs and maintenance   | <u>\$1,000</u>     |                        |
| f. Gas   | <u>\$2,500</u>     |                        |
| g. Insurance payments  | <u>\$3,000</u>     |                        |
| h. Total of all expenses<br>(This is your total actual expense)  |                    | <u><b>\$12,000</b></u> |
| 8. Divide Line 5 by Line 1<br>(The result will be a decimal number 1.0 or less)                              | (7,000/20,000)     | <u>.35</u>             |
| 9. Multiply Line 7h by Line 8.   | (\$ 12,000 X 0.35) | <u>\$4,200</u>         |
| 10. Business Parking Fees and Tolls  |                    | <u>\$500</u>           |
| 11. Add Lines 9 and 10<br>(This is your total allowable deduction using the actual auto expense computation) |                    | <u><b>\$4,700</b></u>  |
| 12. Your allowable auto expense deduction is the <b>larger</b> of Line 6 or Line 11.                         |                    | <u><b>\$4,700</b></u>  |

We will adjust Jane's 2003 Schedule C expenses by \$2,300, the difference between the amount she reported, and her allowable deduction (\$7,000 - \$4,700 = \$2,300).

### Establishing the right to a refund

While most claims for refund are made on a completed amended return with a sufficient level of support, we have recently been seeing an influx of claims that are not providing enough information for us to determine whether the taxpayer has established a right to the refund. Moreover, some taxpayers do not have information readily available when we request it.

We are reminding all taxpayers to include a sufficient level of support for their refund when they file their claims. This will expedite consideration of your clients' claims, and refund processing. Sufficient support includes forms, calculations, or schedules used in determining the amount of refund, as well as detailed explanations for the change. For example, amended returns filed to claim an Enterprise Zone credit should include FTB Form 3805Z, *Enterprise Zone Deduction and Credit Summary*; Schedule Z, *Computation of Credit Limitations – Enterprise Zone*, and all worksheets referenced in the Form 3805Z.

Claims for refunds must be in writing, signed by the taxpayers or their agents, and must specify the grounds on which the claims are based. The taxpayer must also "affirmatively establish the right to a refund of the taxes by a preponderance of the evidence."

(*Consolidated Accessories Corp. v. Franchise Tax Board* (1984) 161 Cal.App.3d 1036, 1039; *Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 442; *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.)

In other words, the choice to file claims for refund obligate taxpayers with the burden to establish by a "preponderance of evidence" that they have the right to the claimed refund. When appropriate, we may request in writing that the taxpayer provide a completed amended return, and a sufficient level of support within a certain number of days. The claim may be denied if the information is not provided within the time requested.

Taxpayers should have documentation that supports their claim amount and basis readily available when they file their claims. For example, in a claim for refund to report an Enterprise Zone credit, documentation would include relevant accounting or financial records, such as payroll records, fixed assets journals, invoices, hiring credit vouchers, tax credit studies or other key documents required to substantiate the basis of the claim for refund. Making sure that your clients provide the right information at the time the claim is filed, and have the substantiating documentation readily available upon request, accelerates the resolution of all claims.

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## Notes from the Tax Practitioner Stakeholder Specialist

### Conformity: AGI phase out limits

For 2008, the AGI phase out limits for IRAs have been indexed for federal purposes. There has been some confusion over whether or not California conforms to these indexed amounts. California does conform to the federal Roth IRA phase out amounts, but **not** the new federal Traditional IRA phase out amounts. Therefore, although Roth IRA phase out amounts for California purposes are the same as federal, your clients could potentially have a different federal basis than state basis if they fall between the phase out limits, and are contributing to a traditional IRA.

Here are the 2008 phase out amounts:

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**Traditional IRA phase-out range**

Filing status	Federal	California
Single	\$52,000 – \$62,000	\$50,000 – \$60,000
Joint returns	\$83,000 – \$103,000	\$75,000 – \$85,000
Individual not active participant, but spouse is included	\$156,000 – \$166,000	\$150,000 – \$160,000

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**Roth IRA phase-out range**

Filing status	Federal	California
Single	\$99,000 – \$114,000	\$99,000 – \$114,000
Joint returns	\$156,000 – \$166,000	\$156,000 – \$166,000
Individual not active participant, but spouse is included	\$156,000 – \$166,000	\$156,000 – \$166,000

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**Inside FTB****“View Payments and Balance Due” Web service to take brief holiday**

In our November issue, we told you about a new online service that will debut in January: **“My FTB Account.”** It will replace our current online service, **“View Payments and Balance Due,”** which will be unavailable on several dates in December as we make the transition to **My FTB Account.**

The **View Payments and Balance Due** service allows you to view:

- Estimated tax payments.
- Recent payments applied to a balance due.
- Total current balance due.
- A summary of each balance due tax year on an account.
- Amnesty balance after applying for amnesty.

**View Payments and Balance Due** will be temporarily unavailable on these December dates:

- From 5:00 p.m. Monday, December 24, through 7:00 a.m. Wednesday, December 26.
- From 5:00 p.m. Friday, December 28, through 7:00 a.m. Wednesday, January 2.

When service resumes on January 2, **My FTB Account** will be available to bring you even more great features, including California wage and withholding information.

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## **Criminal Corner**

We are committed to closing California's \$6.5 billion tax gap, defined as the difference between tax that is owed, and tax that is paid. Our special agents work cooperatively with law enforcement agencies throughout California to uncover illegal behaviors that contribute to the tax gap. These include underreporting income, overstating deductions, failing to file returns, failing to pay taxes due, and making illegal cash payments to employees.

Tax fraud is not a victimless crime. You can report suspected tax fraud by calling FTB at (800) 540-3453.

### **Inland empire tax preparer sentenced on state tax fraud**

A Riverside tax preparer pleaded guilty to one count of state income tax fraud for filing fraudulent returns on behalf of her clients.

Debbie Lynn Kleitz, 52, owns and operates Kleitz Tax Service. Kleitz was sentenced to 120 days in jail, three years probation, and was ordered to pay restitution to the FTB of more than \$43,800 representing the tax, fines, and cost of the investigation. In addition, she can only file fully completed tax returns.

According to court documents, Kleitz fraudulently filed married clients' tax returns using either head of household status or single filing status. In some cases, Kleitz would also fraudulently inflate child and dependent care expenses to further increase the size of the refund. Kleitz benefited by charging the clients for two prepared returns rather than one married filing joint income tax return.

In one example, Kleitz filed a false state income tax return for each spouse and inflated one spouse's child and dependent care credit expenses. That spouse received a \$1,344 refund while the other received a \$531 refund. The couple's correctly filed amended state income tax return resulted in a \$620 state income tax refund.

The case was discovered by FTB's internal fraud detection group.

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## **The buzz on big business**

### **Sales Factor: analytical guidance regarding treasury function receipts**

The Franchise Tax Board issued Technical Advice Memorandum (TAM) 2007-3 to staff discussing what information should be collected at Audit with respect to treasury activities as a result of the California Supreme Court decisions in *Microsoft* and *General Motors*. The TAM includes a discussion on whether information should be collected relating to repurchase agreements, commonly referred to as "repos." Complete information regarding repos, including returned capital, is necessary to verify the amount of receipts that should be included in the denominator of the sales factor under California Revenue and Taxation Code (CRTC) Section 25120. In the *Microsoft* decision it was determined that the CRTC Section

25137 distortion analysis of the treasury department activity was needed, including the profit margins on all transactions; thus the need for analysis of the repo activity as well.

It was concluded in TAM 2007-3 that Audit staff should continue to collect information with respect to all treasury activities so that the circumstances of each case can be compared to the analysis and metrics (measuring tools) provided in *Microsoft*, *General Motors*, and other cases. Those cases do not establish bright-line tests, or limit the approaches that can be used.

For more information about TAM 2007-3, contact our Disclosure Office at (916) 845-3226.

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